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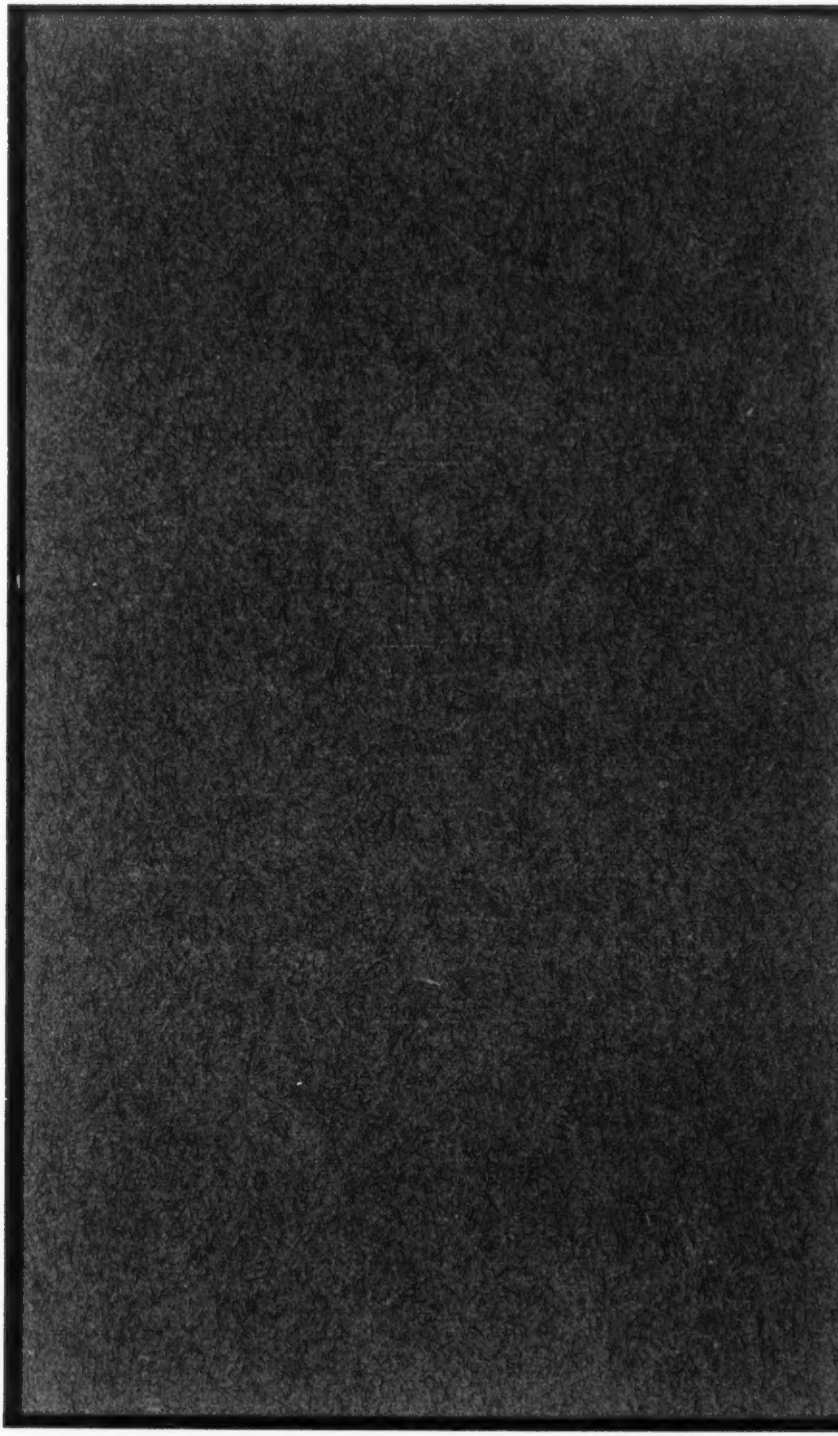

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In the Supreme Court of the United States

OCTOBER TERM, 1944

No. 515

FERDINAND W. ROEBLING, III, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The memorandum opinion of the Tax Court (R. 15–25) is not reported. The opinion of the circuit court of appeals (R. 38–46) is reported in 143 F. 2d 810.

JURISDICTION

The judgment of the circuit court of appeals was entered on July 1, 1944 (R. 46–47). The petition for a writ of certiorari was filed on September 28, 1944. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether the merger of two corporations under the laws of the State of New Jersey constitutes a reorganization under Section 112 (g) (1) (A) of the Revenue Act of 1938 when the stockholders of one of the merging corporations received in exchange for their stock one hundred year bonds in the reorganized corporation, but no stock.

STATUTE AND REGULATIONS INVOLVED

The relevant provisions of the statute and regulations involved are set forth in the Appendix, *infra*, pp. 11–14.

STATEMENT

The facts in this case were all stipulated and were found, as stipulated, by the Tax Court. The taxpayer was the owner of 166 shares of stock of South Jersey Gas, Electric and Traction Company which had, for tax purposes, a basis to him of $16,600. In June 1903, South Jersey leased all of its franchises, plants, and operating equipment to Public Service Corporation of New Jersey for 900 years. The lessee was to pay rent which, beginning December 1, 1908, amounted to $480,000 per annum. In addition the lessee agreed to pay the interest charges on the lessor's bonded indebtedness, all taxes, insurance, and such sums as were necessary to maintain, repair, improve, and extend the leased properties. All replacements and additions became the property of South Jersey and subject to the terms of the

lease. (R. 16.) South Jersey could enter upon the leased property for the purpose of inspecting it, determining its condition and the character of the management, and whether the covenants of the lease were being complied with. Upon default of the terms of the lease for a period of 30 days, after notice, South Jersey could terminate the lease, reenter and reacquire the property and additions and extensions thereto. In July 1924, this lease was assigned by Public Service Corporation of New Jersey to Public Service Electric and Gas Company which assumed the obligations thereof. (R. 17.) From December 1, 1908, to June 1, 1937, the net rentals received by South Jersey, the lessor company, were distributed to its stockholders at the rate of 8% per annum on the par value of its stock.

South Jersey had 60,000 shares of capital stock of $100 par value outstanding, of which Public Service Electric and Gas Company, the assignee of the lease, held 1,705 shares, and Public Service Corporation of New Jersey, the original lessee, held 15,773 shares. The remaining 42,521 shares were held by other interests. Public Service Corporation of New Jersey held substantially all the voting stock of Public Service Electric and Gas Company. (R. 17.)

On May 10, 1937, the directors of South Jersey and of Public Service Electric and Gas Company adopted a "Plan of Reorganization" under

which it was proposed that the former company be merged in the latter in accordance with the statutes of New Jersey. This plan provided that the stockholders of South Jersey should exchange their stock in South Jersey, dollar for dollar, for eight percent, one hundred year, first mortgage bonds of Public Service Electric and Gas Company. These bonds were to be issued under a prior mortgage of Public Service Electric and Gas Company dated August 1, 1924, and under a supplemental indenture later to be executed. (R. 18–19.) It was expressly provided in the "Agreement of Merger", executed on the same day, that: "The capital stock of the Public Service Electric and Gas Company * * * will not be changed by reason of this agreement." The stock of South Jersey held by Public Service Electric and Gas Company was not to participate in the exchange but was to be delivered up and cancelled. (R. 19–20.) The "Agreement of Merger" was accepted by the stockholders of South Jersey and of Public Service Electric and Gas Company, and approved by the Board of Public Utilities Commissioners of the State of New Jersey and by the Federal Power Commission. With the certificates of the secretaries of the constituent companies as to the confirmatory votes of the stockholders, and the certificates of approval of the Public Utility Commissioners of New Jersey and of the Federal Power Commis-

sion, the "Agreement of Merger" was filed with the Secretary of State of New Jersey on November 17, 1938. (R. 20.)

In accordance with the agreement, the taxpayer received in exchange for his 166 shares of stock in South Jersey, $16,600 principal amount of eight percent bonds which, on November 25, 1938, had a fair market value of $34,777 (R. 21). The Commissioner held that the taxpayer's gain on the exchange of stock for bonds was taxable, and he asserted a deficiency for the calendar year 1938 which the Tax Court sustained, so far as it was based upon this item (R. 21–25). The decision of the Tax Court was affirmed by the circuit court of appeals (R. 38–46).

ARGUMENT

The circuit court of appeals properly determined that the gain realized by the taxpayer in exchanging his stock in South Jersey Gas, Electric and Traction Company for the bonds of Public Service Electric and Gas Company was taxable to him under Section 112 (a) of the Revenue Act of 1938, and that the exchange was not tax free under Section 112 (b) (3), as being effectuated in pursuance of a plan of reorganization, as defined in Section 112 (g) (1) (A). (See Appendix, *infra*, pp. 11–12.) In arriving at this conclusion, the court below followed the decisions of this Court which hold that Congress did not intend the reorganization pro-

visions of the various Revenue Acts to be invoked for postponing what might otherwise be a taxable event unless ownership interests are continued in the reorganized corporation. The circuit court of appeals likewise found that the requisite continuity of ownership was not present in this case.

The requirement of continued ownership is firmly established. *Pinellas Ice Co.* v. *Commissioner*, 287 U. S. 462; *Helvering* v. *Minnesota Tea Co.*, 296 U. S. 378; *Nelson Co.* v. *Helvering*, 296 U. S. 374; *Helvering* v. *Watts*, 296 U. S. 387; *LeTulle* v. *Scofield*, 308 U. S. 415; *Helvering* v. *Alabama Asphaltic Limestone Co.*, 315 U. S. 179. The taxpayer contends, however, that the change in Section 112 (g) (1) by the Revenue Act of 1934, c. 277, 48 Stat. 680, indicates a Congressional purpose to make the reorganization provisions applicable when there is, without more, a merger or consolidation under the laws of a particular state (Pet. 7–13).

The changes made in Section 112 (g) (1) by the Revenue Act of 1934, which are set forth in the taxpayer's petition (pp. 9–10), give no support to the construction urged by the taxpayer. Indeed, these changes were prompted by the Congressional desire to prevent tax avoidance and achieve uniformity, and the House Committee report, after stating that the "definition of a reorganization has been restricted", reveals its

familiarity with and approval of the rulings of this Court, holding the reorganization provisions applicable only where corporations undergo mere changes in form "with the stockholders continuing their former interest in the original enterprise."[1] The purpose of the insertion of Section 112 (g) (1) (B) (Appendix, *infra*, p. 12), by the Senate Committee,[2] was to exempt reorganizations which met the requirements there enumerated, and so, by allowing such exemptions even in jurisdictions without statutory provision for mergers and consolidations, to approximate uniformity of treatment. Although the standard there imposed is stricter than that previously applied,[3] there is a complete absence of any indication of an intention to abandon the previously existing requirement of continuity of ownership interests with respect to statutory mergers or consolidations. Plainly, the scheme of uniformity and the abatement of tax avoidance sought by the Senate Committee would not have been achieved by such a device. Taxability would turn on state statutory descriptions of "mergers and consolidations" which vary in their imposition of continuity of interest requirements.

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[1] H. Rep. No. 704, 73d Cong., 2d Sess., pp. 12–15 (1939–1 Cum. Bull. (Part 2) 554, 563–565).

[2] S. Rep. No. 558, 73d Cong., 2d Sess., pp. 16–17 (1939–1 Cum. Bull. (Part 2), 586, 598–599).

[3] *Helvering* v. *Southwest Corp.*, 315 U. S. 194.

Finally, the explanations made regarding the conference bill, in which the Senate amendment was adopted, fail to disclose the Congressional purpose which taxpayer asserts existed.[4] It is indeed strange, if Congress did intend to abrogate the continuity of interest test for statutory mergers and consolidations, that the congressional committees, in their detailed reports on the section, made no mention whatever of this purpose to change the law.

Treasury Regulations 86, Art. 112 (g)-1-3, promulgated under the Revenue Act of 1934, construed the statute as continuing the requirement that continuity of ownership exist in connection with a merger or consolidation under state law. That interpretation has been embodied in all succeeding Treasury Regulations promulgated under subsequent Revenue Acts and under the Internal Revenue Code. Section 112 (g) of the Revenue Act of 1934 was reenacted without change in the Revenue Acts of 1936, c. 690, 49 Stat. 1648, and 1938 (Appendix, *infra,* p. 12), and in the Internal Revenue Code; it was amended, but only as to unrelated matters, by the Revenue Acts of 1939, c. 247, 53 Stat. 862, Sec. 213 (b), and 1943, Pub. Law 235, 78th Cong., 2d Sess. (Feb. 25, 1944), Sec. 121 (d). The fact that Congress, although it had ample opportunity to do so, has not indicated any disagreement with this interpreta-

[4] H. Rep. No. 1385, 73d Cong., 2d Sess., pp. 21-22 (1939-1 Cum. Bull. (Part 2), 627, 632).

tion of the Treasury Department, is persuasive that the construction sought by taxpayer is erroneous. *Douglas* v. *Commissioner,* 322 U. S. 275, 281–282.

The court below relied on *Commissioner* v. *Gilmore's Estate,* 130 F. 2d 791, 794 (C. C. A. 3d), and *Morgan Mfg. Co.* v. *Commissioner,* 124 F. 2d 602 (C. C. A. 4th), in support of its decision. Taxpayer states that those cases do not involve "the precise point presented here." (Pet. 12.) We do not agree. Although there are factual differences between the present case and each of those cases, they do recognize that the continuity of interest test was not removed from application to corporate mergers and consolidations carried out under state law. The *Morgan* case involved Section 112 (g) (1) (A) of the Revenue Act of 1936 and the *Gilmore* case involved the same section of the 1934 Act.

The argument is also made that the requisite continuity of interest was present in this case (Pet. 2, 13). We do not believe that it requires any elaborate analysis to show that when the stockholders of one corporation give up their proprietary interests and assume, in exchange, the position of creditors holding one hundred year, first mortgage bonds of the merged corporation, there is no continuity of ownership. *LeTulle* v. *Scofield,* 308 U. S. 415.

CONCLUSION

The decision of the circuit court of appeals is correct. There is no conflict of decisions. Accordingly, this petition for a writ of certiorari should be denied.

Respectfully submitted,

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OCTOBER, 1944.